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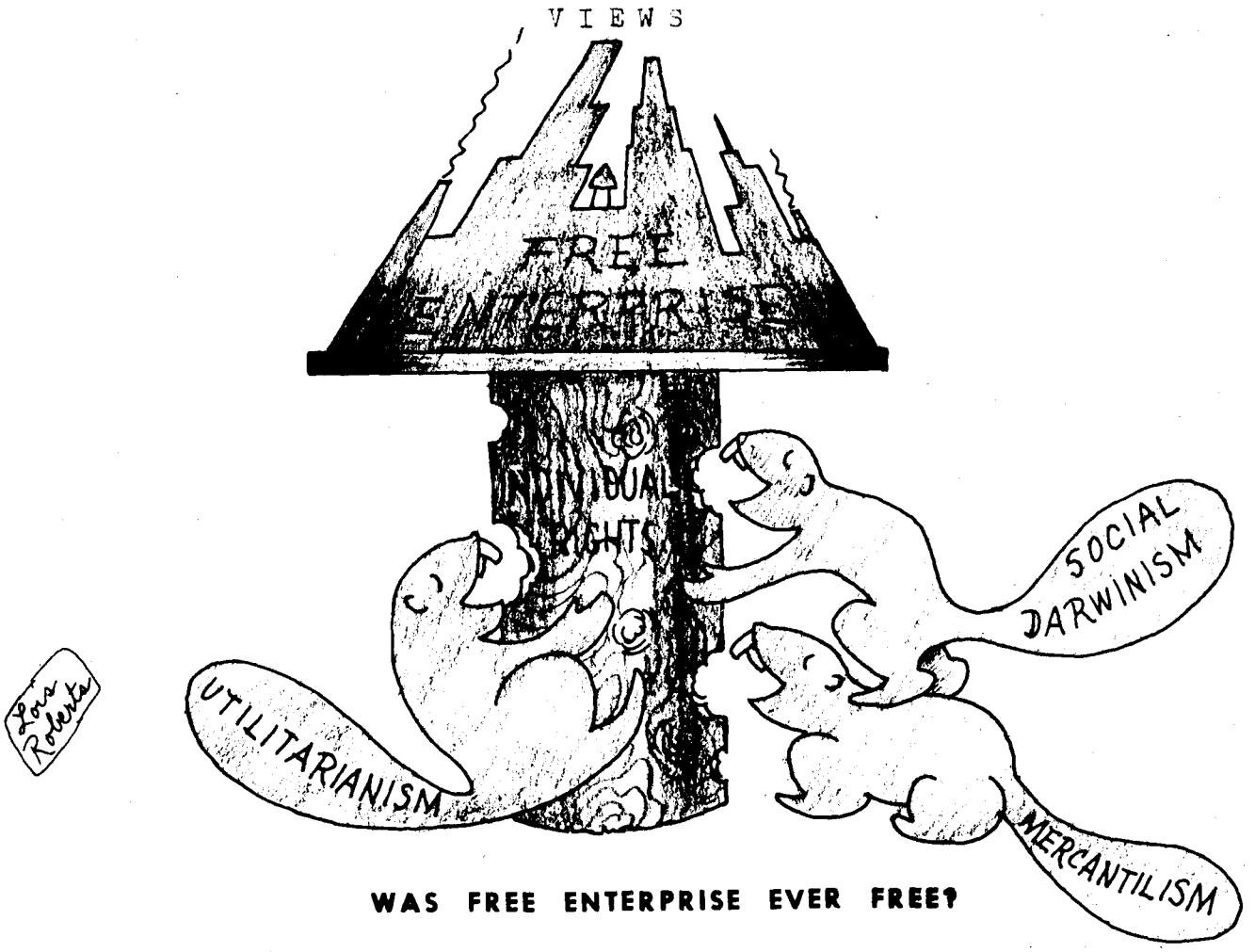

WAS FREE ENTERPRISE EVER FREE?

PART II -- THE RISE AND FALL OF LAISSEZ-FAIRE IDEALS

In the July issue of Persuasion, Part I of this study, I traced the influence of the colonial mercantilist heritage. I further suggested that laissez-faire economic principles were beginning to influence the colonists at the end of the eighteenth century. It was inevitable that the ideas of

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mercantilism (advocating government supervision of economic affairs) and laissez-faire (advocating total economic freedom) would clash. The Founding Fathers attempted to blend the two diametrically opposed economic doctrines at the Constitutional Convention in 1787.

But first, let's examine what laissez-faire is and where the idea originated. It is the theory of noninterference by government in economic affairs. It implies philosophically the concepts of human rights, individualism and self-interest, political freedom, and limited government--philosophical ideas which can be traced to the seventeenth-century philosopher John Locke (1632-1704). Although spokesmen for laissez-faire in the last two centuries have seldom agreed about the proper extent of the government's role in economics, they would generally agree that laissez-faire specifically means the following: Individuals or voluntarily associated groups of individuals have the right to seek the maximum of personal profit by producing, buying and selling whatever they wish and in any way they wish, so long as they do not violate the rights of others. Prices and standards in a market economy are determined by free competition (supply and demand). Economic activities should go on with little or no interference from government authorities, in the form of either restraints or favors. John Taylor, the outspoken defender of Jeffersonian economic ideas (1753-1824), expressed this point well: "The utmost favor which it is possible for a government to do for us farmers and mechanics is neither to help us nor hurt us."[1]

The term "laissez-faire" was first used in eighteenth-century France by the Physiocrats, a group of French economists (including Quesnay, Gournay, Turgot, Mirabeau, Dupont de Nemours and others) who adopted the motto "laissez faire, laissez passer" ("let do, let pass"). The Physiocrats were reacting strongly against mercantilism, which had been particularly oppressive in France under Colbert.

The Physiocrats emphasized private property rights and they generally agreed that the only purpose of the government is to protect life, liberty and property, so that men can be free to pursue their economic self-interest. They demonstrated that the French government's restrictions of economic enterprises actually retarded production and contributed to great inefficiency. Familiar with Locke (who is sometimes called the Father of the Physiocrats), they campaigned for free trade and the liberation of productive forces, particularly in agriculture. Their ideas are sometimes referred to as the Agricultural System, since they mistakenly thought that only agriculture was able to increase "real" national wealth; they considered commerce and manufacturing non-productive.

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While the Physiocrats were active in France, Adam Smith (1723-1790), a Scotchman of their acquaintance, was writing Wealth of Nations. In general, Smith espoused laissez-faire principles as the surest road to prosperity, but he was not an advocate of what I shall call "pure" laissez-faire, that is, total economic freedom.[2] His economic theories should be considered an admixture of laissez-faire and mercantilism.

For example, Adam Smith thought that the government's functions should include, in addition to defense, administration of justice, enforcement of contracts and the administration of patents and copyrights, the following: the post office, public education and the erection and maintenance of "certain public works and certain public institutions /particularly roads, highways, bridges, canals and harbors/ which it can never be for the interest of any individual, or small group of individuals, to erect and maintain."[3] He also believed that a government might properly interfere in foreign commerce and banking; legally fix interest rates; and tax rent, profits, and wages.[4] Advocates of a strict, literal interpretation of laissez-faire, however, would limit the sphere of the government's activities to the protection of rights (including patents, copyrights and contracts), by means of the armed forces, the law courts, and the police. All of the other functions of government which Smith advocated would be privately created, owned and maintained under pure laissez-faire.

The followers of Adam Smith are usually called the Classical School. It includes such well-known economic theorists as Ricardo and Malthus and the Manchester School. The latter was a group of men centered around the Manchester Chamber of Commerce in England, who staunchly advocated free trade and a practical application of Smith's ideas. The school influenced Bastiat, who helped spread Smith's ideas in France.

The term "liberalism" originated in reference to Smith's European disciples, particularly French Classicists such as Jean Baptiste Say (1767-1832), an eloquent defender of economic freedom.[5] The term "classical liberal philosophy" is used loosely today to describe the ideas of all those who advocate, to one degree or another, economic and political freedom, parliamentary systems of government, and governmental guarantees of individual rights.

Laissez-faire found a champion in Jeremy Bentham (1748-1832), author of A Fragment on Government (1776). He was a philosopher who espoused a hedonistic

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utilitarianism ("the greatest happiness for the greatest number") as the justification for his advocacy of economic freedom. Bentham argued that government interference in economic affairs is needless and pernicious; he thought that competition should be allowed almost unlimited freedom. Unlike defenders of capitalism in the Lockean tradition, however, Bentham declared that the concept of individual rights is a fiction.

It is one of the most striking coincidences of history that the world's first comprehensive and scientific treatise in the newly emerging science of economics, Smith's Wealth of Nations, appeared in the same year that Bentham published A Fragment on Government, that Watt invented the steam engine, and that the Declaration of Independence was signed in the United States--1776. Smith's book laid the groundwork for the science of economics. Bentham's work contained a justification for capitalism that was unfortunately to replace the philosophy of rights. Watt gave an enormous impetus to the Industrial Revolution in England and America. The Declaration of Independence made possible the creation of a nation that embraced the achievements and ideas of all three men.

Classical theories of economics were not long in finding their way to the United States. Their chief exponent was Thomas Jefferson. Jefferson was familiar with the Wealth of Nations and praised its ideas. He was personally acquainted with some of the Physiocrats and carried on an extensive correspondence with Dupont de Nemours[6] and Jean Baptiste Say, author of A Treatise on Political Economy (1820).[7] Benjamin Franklin's early mercantilist ideas altered after the influence of the Physiocrats on his visit to France in 1767. In fact, C.C. Biddle, editor of an 1836 edition of Say's book, points out that the expression "laissez-faire" became widely circulated in the United States through the efforts of Franklin.[8] James Madison, John Jay and Alexander Hamilton stated in The Federalist[9] that the ideal system would be complete freedom of trade, but they were afraid that America would jeopardize both her independence and her profits if she advocated free international trade, while other countries imposed tariffs on American ships.

When the Founding Fathers met to draft the Constitution in 1787, they brought political theories influenced by Locke's concepts of rights, self-government and equality. In addition, they espoused economic principles that were a curious mixture of laissez-faire and mercantilism. As we saw in Part I of this article, their colonial experiences had made them very familiar with mercantilism and its tariffs, regulations, price-fixing, subsidies, bounties, monopolies and taxes.

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The ideas of laissez-faire and the economic principles underlying free market economies, however, were new and had barely had an opportunity to become widely known and understood. (Economics as a science was not founded until the Physiocrats developed the first comprehensive body of economic principles.[10]) Nevertheless, many of the delegates to the Federal Convention were attracted to the ideas of economic freedom because they were logically compatible with a political philosophy of rights and liberty. The ideas of Smith and the Physiocrats were particularly influential; many of Smith's economic principles were incorporated into the Constitution of the United States.

Regardless of their specific disagreements about the role of government in economic affairs, however, it is important to bear in mind that the Founding Fathers all agreed on one basic principle: They agreed that their job was to preserve liberty.

Frederick K. Henrich in the Journal of Economic History[11] describes the types of economic freedom that were being defended in this era and states that "every single laissez-faire theorist was also an advocate of some kind of intervention." Henrich points out that there were four types of economic freedom being advocated at the end of the eighteenth century: (1) laissez passer--free international trade, which agriculturalists such as Jefferson defended because it encouraged the free exchange of agricultural surpluses for foreign manufactures; (2) laissez faire--a free domestic market, which was the special concern of the commercial interests who fought price-fixing, paper money, and interference with production and consumption; (3) laissez travailler (Henrich's term)--freedom of occupational choice and the right to reap the benefits of one's own labor. Almost all of the colonists favored this liberty; (4) laissez placer (also Henrich's term)--the right to speculate and to make investments (in land, stocks or bonds) with the hope of making a profit; fostered by financial interests. Since there were agrarian groups with a strong physiocratic distrust of moneyed interests, this form of economic freedom was the subject of great controversy. Henrich suggests that each prominent economic group defended "that type of economic liberty which promised to advance the well-being of its constituents."

Alexander Hamilton, who was to have a decisive influence on the future direction of economic life in the United States, was primarily a mercantilist--an ardent nationalist and a staunch defender of encouragement and protection of infant industries by bounties and tariffs. He revealed his attitude toward

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total economic freedom in a speech at the Federal Convention on June 18, 1787: "In matters of industry," he commented, "human enterprise ought, doubtless, to be left free in the main; not fettered by too much regulation; but practical politicians know that it may be beneficially stimulated by prudent aids and encouragements on the part of the government."[12]

As the author of the Federalist Party's economic program, Hamilton established the precedent for tariffs and economic assistance to industry. He was able to defend his policies on constitutional grounds because of the mercantilist clauses in the U.S. Constitution. These clauses, around which the controversy over strict vs. loose construction of the Constitution centered, permit the federal government to: regulate foreign and interstate commerce, operate the postal system, construct post roads, coin money and regulate its value, grant the power of eminent domain, levy tariffs and other duties, etc. These clauses, combined with the "general welfare" clause and Chief Justice Marshall's doctrine of implied powers,[13] have resulted in an ever-expanding national government.

Immediately after the Constitution was ratified, however, what happened to laissez-faire in theory and in practice?

In theory, laissez-faire gathered more and more adherents, particularly after 1820, when the writings of Jean Baptiste Say and Harriet Martineau became popular. Sidney Fine states that "Say's Treatise on Political Economy, a restatement in polished form of the laissez-faire creed, was the most widely used economics textbook in America's colleges up to the Civil War. . . . Insofar as political economy was offered as a college subject before the Civil War, it was taught in strict conformity with the principles of laissez-faire."[14] Illustrations of Political Economy, by Miss Martineau, presented the principles of laissez-faire in story form; the authoress "extends a plea for the 'unimpeded operation' of the entire system of commercial exchanges."[15] Another influential defender of laissez-faire in this period was Francis Wayland, President of Brown University and author of Elements of Political Economy (1837), who attacked poor laws as destructive of property rights, and internal improvements and banking regulations as improper functions of government.

In theory, the followers of the liberal tradition in America (particularly the Jeffersonians and Jacksonians) were generally opposed to government intervention in the economic life of the country. They favored a strict construction of the Constitution, and usually feared the federal government's potential

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oppressive power. The Jacksonians adopted Adam Smith's attitude toward the dangers and injustices implicit in the alliance of government and business, particularly in the form of government-created monopolies.[16] They undoubtedly saw that they could not exercise equal rights in a society in which monopoly and special privileges prevented free and fair competition among producers.

Martin Van Buren, Jackson's successor, echoed the Jacksonian view: "It's not its [the government's] legitimate object to make men rich or to repair by direct grants of money or legislation in favor of particular pursuits losses not incurred in the public service. This would be substantially to use the property of some for the benefit of others."[17]

In the period between the Civil War and 1900, the doctrine of laissez-faire reached its height of popularity. It was championed by professional and popular economists; political scientists; clergymen; Herbert Spencer and his followers, the Social Darwinists; businessmen; but most of all by the legal fraternity and members of the Supreme Court. It was in the courts that laissez-faire won its most significant victories in the nineteenth century. In 1868, Judge Thomas M. Cooley published Constitutional Limitations; "in that year laissez-faire capitalism was supplied with a legal ideology."[18]

Cooley developed a system of law based on the protection of property rights and liberty of contract. Also in 1868, the Fourteenth Amendment was ratified. The Supreme Court eventually used the "due process" clause of this amendment as the chief defense of property and business operations against interference by state legislatures. "There is a general consensus that, for a long period starting in the 1880's [with Justices Field, McKenna, Brewer and Sutherland, in particular], laissez faire was given a doctrinaire interpretation by the Supreme Court. . . ."[19]

But, and it is a big but, the purpose of the Supreme Court is to decide on the constitutionality of laws. The mercantilist provisions in the Constitution itself could not be ignored. This meant that while laissez-faire was flowering in theory before the Civil War, in practice it never totally got started. Laissez-faire advocates a free market. As I have demonstrated, the market economy of the early Republic was never really free. To one extent or another economic affairs in this country have always been influenced by government action. The federal government, prior to the Civil War, for example, in the name of constitutional provisions, was able to foster the following: tariffs and duties,

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taxation, subsidies and bounties to industry, grants of monopoly privileges and other forms of government patronage (e.g., land grants), government-owned business enterprises, internal improvements (canals, railroads, turnpikes) and regulatory measures. In 1863, the federal government formed and regulated the national banking system.

State governments were even more active during the first sixty years of the Republic. There was often a direct continuation of mercantilist policies from the colonial period to statehood. The states provided licensing services, regulated banks and insurance companies, inspected and regulated the quality of exported goods, and granted charters of incorporation (sometimes with monopolistic privileges). They subsidized agricultural and industrial fairs, gave bounties for certain crops, and extended special loan privileges to farmers.

State governments were also very active in business enterprises of their own. Louis Hartz notes that the state of Pennsylvania was involved in "business life to a degree unprecedented in the eighteenth century. Profits were limited, prices fixed, monopolistic practices among merchants prohibited. . . . In some of the corporations it chartered it subscribed and owned as much as half of the stock. A kind of mixed corporation developed."[20] Some states, however, did not allow tampering with prices. In general, the states also did not interfere with contracts, occupational choices or the activities of speculators.

The states also were actively engaged in promoting internal improvements. Many of them saw their programs end in total disaster, and as a result several states passed constitutional amendments in the 1840's prohibiting such activity. In the decades following the Civil War, many states were forced to give up their business activities, because it became clear that private enterprise was more efficient.

Nothing, however, seemed to prevent state governments from joining the federal government in an unprecedented program of assistance to one industry: the railroads. "Railways received support in the form of federal loans, liberal land grants and indirect aid in the form of a remission of the tariff on imported railroad rails. At first the federal government made land grants to the states which were turned over to railroad corporations. In 1862 the policy of giving federal land grants directly to the railway companies began. State and town governments often paid railway survey expenses, subscribed to railroad stock, or

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floated bond issues on behalf of the railroads."[21] The railroads with the most financial difficulty and the worst history of scandal were the Union Pacific and the Central Pacific; they went into bankruptcy. They were also the railroads which had received the greatest amount of federal assistance.

Despite this array of government intervention, it is important to remember that the U.S. economy of this period was the freest in the history of the entire world. Compared to government regulation today, the early days of the Republic, in retrospect, are indeed enviable. ". . . governmental activities that a typical American of the pre-Civil War period would have considered a serious departure from his conception of a laissez-faire policy might be received as a very minor matter by the American brought up under the social attitudes of today."[22]

Unfortunately, those people who defended laissez-faire in early America did not advocate pure laissez-faire. The Founding Fathers provided for an economic order based on the foundation of freedom and rights, but gnawing away at this foundation were the provisions of federal and state constitutions providing for government intervention in the economy. Freedom toppled, particularly after 1865 when the scope of the activities of federal, state and local governments steadily increased. But before economic freedom was all but destroyed by a wave of collectivism, it unleased a burst of industrial production which in one hundred years turned an agrarian country of four million people into an industrial nation of 63 million with the highest standard of living in the history of the world.

Gradually, as government intervention increased, the ideas of laissez-faire, once so respectable and popular, declined in influence. Those who now attack laissez-faire capitalism claim that it had its chance and it failed, because it allegedly was either responsible for or could not provide solutions for the undesirable social and economic problems of the new industrial age.

In fact, however, laissez-faire capitalism never existed in the United States. As Ayn Rand has identified, "What existed in practice, in the 19th century, was not pure capitalism, but variously mixed economies. Since controls necessitate and breed further controls, it was the statist element of the mixtures that wrecked them; it was the free, capitalist element that took the blame."[23] To accuse laissez-faire is to accuse a straw man, erected to blind a smoke-screen over the real causes of the problems of this era.

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Specifically, for example, laissez-faire took the blame for labor problems, depressions and the rise of coercive monopolies, all of which were the result of the mercantilist principles and practices of state and federal governments. The following quotation is an example of what I mean: "In the face of such great questions as the growing labor problem, railway discrimination, and monetary difficulties, all accentuated by the crises of 1873 and 1884, the old policy of laissez faire was proving inadequate."[24]

The anti-capitalist myth accuses capitalism of being the creator of intolerable working conditions for laborers. "The common charge of inhumanity against the nineteenth century--for that is the popular reading of the policy of laissez faire, is it not?--would be an idle slander if it were not so gross."[25] Historians and economists have given ample evidence to prove otherwise.

"The truth is that, for the greater part of history, for most men the possession of the tools for their work was an essential condition for survival or at least for being able to rear a family. . . . To be left without them meant in most instances death by starvation or at least the impossibility of procreation. . . . It was only when the larger gain from the employment of machinery provided both the means and the opportunity for [the investment of the tools] that what in the past had been a recurring surplus of population doomed to early death was in an increasing measure given the possibility of survival. . . . The proletariat which capitalism can be said to have 'created' was thus not a proportion of the population which would have existed without it or which it had degraded to a lower level."[26]

Under especially heavy attack have been the so-called evils pertaining to working conditions, wages, and the employment of women and children. Robert W. Smuts, in Women and Work in America, documents the reason why children and women worked in factories--to augment family incomes with wages that were often necessary for survival. "To people who had never before experienced the advantages of having money, the lure of regular wages was often irresistible. . . . The textile towns were inhabited largely by families who welcomed the abundant employment opportunities for women and children."[27] As Mr. Smuts points out, what by our standards were harsh conditions, were welcomed by laborers as infinitely preferable to the back-breaking agricultural labor, long working hours, and low incomes prevalent in the pre-capitalist era. Infant mortality declined sharply and populations doubled and trebled during the Industrial Revolution. It is indeed tragic that capitalism, the true benefactor to human life, is still popularly believed to be inhuman.

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Depressions are also alleged to be an inevitable result of laissez-faire. But depressions are not inherent in a free economy. They are the result of the government's manipulation of the money supply, destruction of the gold standard, creating inflation with issues of paper money, cheap-money policies leading to an over-extension of credit, artificial lowering of interest rates, etc. Business cycles are "the consequences of political interference with the free-market economy," states the late Professor Faustino Ballvé, who presented an analysis of this principle.[28]

Without fail, those who attack capitalism claim that an unregulated economy always fosters coercive monopolies. "But it is impossible to find a single example of a monopoly that has ever existed without official protection," states Professor Ballvé.[29] Professor Ballvé demonstrates, in fact, that monopolies are impossible under total free enterprise, because entrepreneurs will always rise to compete with other entrepreneurs. No one in a free economy would have the right to forbid others to compete with him. Coercion of this sort is possible only with government protection by law, by special franchises, subsidies or other privileges. Nineteenth-century railroad monopolies, cited by Professor Haney in his indictment of laissez-faire, were blatant examples of government intervention.[30]

It seems abundantly clear that the attacks on laissez-faire were often aimed at areas of the economy where government intervention had been firmly entrenched. Or laissez-faire was attacked by those who failed to remind themselves of the relevancy of considering historical context. Why, one might ask, did the laissez-faire doctrine fall into disrepute and take the blame? It was destroyed because, as Ayn Rand has identified, it was philosophically defended as a system that served group interests rather than as a system that defended individual rights.[31] Miss Rand points out that the Founding Fathers accepted and proclaimed man's right to life, liberty and the pursuit of happiness. Capitalism, however, has always been defended on altruistic grounds: by utilitarians, who considered rights a fiction (Jeremy Bentham), or by Social Darwinists, who considered that capitalism aided the race by destroying the unfit (Herbert Spencer).

Miss Rand shows how capitalism, without a clearly defined moral basis and defense, was helpless under the vigorous attack of collectivists and statists. She points out that it is impossible to defend the doctrines of political and

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economic freedom, except with "a new morality of rational self-interest."[32]

Fortunately, future spokesmen for capitalism can defend the principles of pure laissez-faire capitalism, because Ayn Rand has formulated a morality of rational self-interest: Objectivism. With this new morality, perhaps America will someday have a laissez-faire economic system--completely unregulated free enterprise-- for the first time in its history.

--Joyce F. Jones

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NOTES

1. Sidney Fine, Laissez Faire and the General-Welfare State (Ann Arbor, University of Michigan, 1956), p. 13.
2. Jacob Viner, "Adam Smith and Laissez Faire," Journal of Political Economy, XXXV, 1927, pp. 198-232.
3. Harry K. Girvetz, The Evolution of Liberalism (New York, Collier, 1963), p. 76.
4. Lewis H. Haney, History of Economic Thought (New York, Macmillan, 1949), pp. 228-231.
5. Ibid., p. 911.
6. Gilbert Chinard, ed., The Correspondence of Jefferson and Du Pont de Nemours (Baltimore, Johns Hopkins, 1931). Contains an informative introduction.
7. An English edition of Say's book first appeared in 1821.
8. Jean Baptiste Say, A Treatise on Political Economy, ed. C.C. Biddle (Philadelphia, Grigg and Elliot, 1836), p. xi.
9. The Federalist consists of eighty-five essays in defense of the Constitution, published primarily in the New York press between October, 1787, and May, 1788, by John Jay, Alexander Hamilton and James Madison, under the nom de plume of Publius. The Modern Library Edition, Random House, is recommended because it is well indexed. Joseph Dorfman also discusses the attitudes of the Founding Fathers in The Economic Mind in American Civilization: 1606-1865, Vol I (New York, Viking, 1946), particularly in Book Two.

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10. Haney, p. 169.
11. "The Development of American Laissez Faire," December Supplement, 1943, pp. 51-54. (The Supplement also includes three articles tracing the history of laissez-faire thought in Massachusetts, Pennsylvania and Georgia from the colonial period to the post-Civil War era.)
12. Fine, p. 15.
13. Enunciated in McCulloch v. Maryland (1819). Marshall's reasoning may be found in 4 Wheaton 401-415, 420, 423; or in The Making of American Democracy: Readings and Documents, Vol. I (New York, Rinehart, 1950), pp. 195-199.
14. Fine, pp. 10 and 12.
15. Ibid., p. 10.
16. Arthur M. Schlesinger, Jr., The Age of Jackson (New York, New American Library, 1955), p. 123.
17. Fine, p. 14.
18. Benjamin R. Twiss, Lawyers and the Constitution: How Laissez Faire Came to the Supreme Court (Princeton, University Press, 1942), p. 18.
19. Girvetz, p. 87.
20. "Laissez-Faire Thought in Pennsylvania, 1776-1860," Journal of Economic History (December Supplement, 1943), pp. 67 and 69.
21. Joyce F. Jones, Citizenship Education (New York, Monarch Press, 1966), p. 88. (A high school review book)
22. Wright, Chester W. Economic History of the United States (New York, McGraw-Hill, 1941), p. 889.
23. Ayn Rand, "What is Capitalism?" Part II, The Objectivist Newsletter, Vol. 4, December, 1965, p. 60.
24. Haney, p. 884.
25. L.M. Hacker, "The Anticapitalist Bias of American Historians," in Capitalism and the Historians, ed. F.A. Hayek (Chicago, University Press, 1954), p. 66.
26. F.A. Hayek, "History and Politics," in Ibid., pp. 15-16.
27. New York, Columbia, 1959, pp. 58 and 121.
28. Arthur Goddard, trans., Essentials of Economics (Princeton, Van Nostrand, 1963), p. 58.
29. Ibid., p. 54.
30. Ayn Rand discusses the railroad industry in detail in a pamphlet, "Notes on the History of American Free Enterprise" (New York, Nathaniel Branden Institute, 1959).
31. "What is Capitalism?" op. cit.
32. For the New Intellectual (New York, Random House, 1961), p. 63.

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REVIEWS

EXPLODING EXPLOITATION

The Exploitation Theory, by Eugen von Böhm-Bawerk, translated by George D. Huncke and Hans F. Sennholz. Libertarian Press, South Holland, Illinois, 1960.

This book, which is an excerpt of 80 pages (p. 241-321) from a three-volume work which appeared at the turn of the century in Germany (Capital and Interest, by Eugen von Böhm-Bawerk) is valuable to every defender of capitalism for two reasons. It gives a clear statement of the background and argumentative force of two related theories which are the central prop of the socialist-communist economic approach: the labor theory of value and its logical consequence, which Professor von Böhm-Bawerk names "the exploitation theory." And it demolishes these theories.

The labor theory of value is, as the name implies, the principle that it is only man's labor which gives value to the things of nature. This idea has a history as long as that of the science of economics itself; and like the science of economics, it might be said to have its ultimate origin in the works of John Locke. "For it is labour indeed that puts the difference of value on everything," said Locke in On the History of England's Political Economy, "and let any one consider what the difference is between an acre of land planted with tobacco or sugar, sown with wheat or barley, and an acre of the same land lying in common without any husbandry upon it, and he will find that the improvement of labour makes the far greater part of the value." (quoted in footnote 2)

This idea was formally stated by Adam Smith in his Wealth of Nations and was "adopted word for word" by Ricardo. "The real price of every article, what every article really costs him who wishes to acquire it, is the effort and difficulty of acquisition. What every article is really worth to the man who acquired it and wishes to sell it or to exchange it for something else, is the effort and difficulty which it enables him to avoid and to unload on others." (Smith's Wealth of Nations; Ricardo's Principles, quoted p. 288)

If this statement is true, says Böhm-Bawerk, then what he dubs "the exploitation theory of interest" of the socialists is its logical consequence. For the obvious question that follows is: If the real value of any article is the labor that went into it, then why doesn't in fact the man who performed this labor get all the money from the article's sale? The buyer is not going to pay more for an article than it is worth to him--a sum equal to the amount of work which he is

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avoiding by making the purchase. Therefore, when a factory owner gets part of the purchase price of a manufactured article, what is the source of his income? It is interest on his capital investment. But this must be part of what the laborer should get, because it has to be deducted from the price, which represents only labor. How can this be?

The socialist answer is ingenious. Although the worker does in fact produce the entire value of the product, and so is entitled to all of the income, he has bargained with the factory owner and agreed to take less than his rightful share of the factory's total earnings in exchange for a regular wage. "The capitalist exercises the control over the indispensable means of production which the institution of private property guarantees him, and he uses such control to secure for himself a part of the worker's product." (p. 241) Why did the worker make such a bad bargain? He was forced to, by hunger, because he could not postpone eating until the product was finished and sold. This is the origin of the term "economic force" which one encounters so often in liberal arguments against big business. It is "the situation which places the worker under coercion." (p. 241)

One can easily see that this theory is a powerful justification for all strikes, all business regulation, and all schemes for the "redistribution" of income. These are all, according to the exploitation theory, ways of righting wrongs which have been initiated by the industrialists in the first place. And even if the exploitation theory has been forgotten by those who now mouth the slogans which spring from it, it is important for defenders of capitalism to familiarize themselves with the best intellectual defense of their opponents and to be prepared to answer it.

I have attempted to reproduce here Böhm-Bawerk's summary of the main factors of the exploitation theory, as they appeared in the works of several writers. He makes the point that Smith and Ricardo did not consider that the worker was exploited by the wage contract, but they "may be considered the unwilling godfathers of the exploitation theory," which was formulated in a later period. Although today the exploitation theory (and indeed, the labor theory of value itself) is most closely associated with Karl Marx, Böhm-Bawerk discusses related theories of early non-socialist economists (William Thompson and Sismondi) and of the socialist theorists Proudhon and Rodbertus, giving most of his attention to the exploitation theories of Rodbertus and Marx.

His method is to reproduce the theory of each uncritically, subsequently criticizing it in detail. This results in a division of the points he raises against the basic theory, which I will try to briefly indicate here.

In criticizing Rodbertus, Böhm-Bawerk begins with the observation that Rodbertus considers only certain goods--those which are the products of labor--although he concedes that all goods are also the product of nature (i.e., raw

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materials). But he states that "economics has no concern" (Soziale Frage, quoted p. 257) with goods which are only the products of nature and not of labor. This point of view Böhm-Bawerk labels as "just downright wrong."

His second criticism of Rodbertus is a detailed discussion of the fact that in all socialist exploitation theories, the issue of time is not taken into account. It is perfectly just, says Böhm-Bawerk, that the worker should get paid for what he produces. But even suppose for the moment that he had in fact produced the entire product, as the socialists claim. What that would mean is that the worker would be entitled to the present value of his production now, or the future value of his work (when the product is finished and offered for sale) in the future. But although the worker would complain if he were told that it should be a matter of indifference to him whether he gets paid at the end of the week or has to wait five years for the same amount of money, the entrepreneur is supposed not to care about this issue, and be willing to distribute among his workers now the entire future value of the product. However, since it is an economic law that present goods are more valuable "than identical future goods," what this amounts to is that the socialists want the worker to have more than he has produced--the future value of the finished product (or a proportional share thereof) before the product is finished.

When he turns his attention to Karl Marx, Böhm-Bawerk notes that Marx has a certain right to the association that the labor theory of value now has with his name. Marx, he says, was the first writer to try to prove the theory and not simply to assert it. "From Ricardo to Rodbertus, from Sismondi to Lasalle, no one has deemed it necessary to bolster the principle with any further support than the name of Adam Smith alone. . . . Only very few of the advocates of the labor theory of value are exceptions to that charge, and one of those few is Marx." (p. 290)

Marx's theory of value and of the nature of interest, according to Böhm-Bawerk, starts with an analysis of the nature of commodities, "by which we must understand that he means, not all economic goods, but only those that are produced by labor for disposition on the market." (pp. 281-2) A commodity, says Marx, represents two sorts of value--it has use value, that is, it satisfies needs of some sort, and it is a "material carrier of exchange value," (p. 282) which is "the ratio in which use values of one kind are exchanged for use values of another kind." This ratio is different in different times and places, but Marx was looking for some constant behind it.

What he proceeded to do, and what Böhm-Bawerk explains in detail, is to set up a mathematicization of the problem. A ratio can be written as an equation, says Marx. An equation means that something is identical on both sides of the equals sign, which means that each of the two use values being considered "must be reducible to this third something." (Das Kapital, quoted by Böhm-Bawerk, p. 282) Marx then proceeds to seek the factor to which commodities in such an equation can

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be reduced, and considers only two: that they have use value and that they are products of labor. He eliminates use value as a possibility, on the ground that products are traded for each other which are to be put to very different uses. By this process of elimination he arrives at labor as the constant he was seeking: "If we disregard the use value of objects that can be classified as commodities, then they retain only a single quality, that of being products of labor." (Das Kapital, quoted by Böhm-Bawerk, p. 282)

Now we must disregard the specific kind of labor that went into the production of each commodity and arrive at the idea of abstract "labor time," and we can measure the value of all goods in units of this abstraction.

When we say that goods are valued according to labor time, this does not mean the time it took to produce the goods. It means what Marx called the "socially necessary labor time." Böhm-Bawerk quotes Marx as defining this as "the time required to produce any use value when operating under the conditions of production normally prevailing in a given society, and when utilizing the degree of skill and application normally available there." (Das Kapital, quoted by Böhm-Bawerk, p. 283) In other words, the market is not going to pay you for the year it took you to produce an electric stove by hand when others as good came out of the factory, worked on by 20 people for an average time of an hour per person.

How does the interest which the capitalist gets relate to the problems we have been discussing? Well, now we presumably know that when commodities are exchanged, they are exchanged on the basis of the "socially necessary labor time" which each represents--that this is what is reflected in their price, when goods are exchanged for money. But the capitalist takes money, invests it in such a way as to turn it into commodities, and then sells the commodities at a profit, as interest on the use of his money. How can he do this? The capitalist did no labor--what created his profit? Or as Marx terms it, where does the "surplus value" come from? The answer is that, since it must have been produced by the labor of the workers, the capitalist gets his profit by only paying the worker for part of the time he works. "Capital is therefore not only, as Adam Smith says, control over labor. It is essentially control over unpaid labor. All surplus value, in no matter what specialized form it is later crystallized, whether profit, interest, rent or the like, is by its nature something which has materialized out of unpaid labor time." (Das Kapital, quoted by Böhm-Bawerk, p. 286)

Notice that the "socially necessary labor time," which is determined by what equipment, tools, and factories are available in a society, is the standard by which it is decided what wage a worker should receive, and that the factory owner is not entitled to any return on his investment. This can only mean that a factory is considered by Marx to be what is termed in economics a "free gift of nature," along with air, sunlight and water, which therefore is not to be taken into economic consideration.

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Böhm-Bawerk likens Marx to "one who has a strong desire to demonstrate that a white ball can be drawn out of an urn, and takes the precaution to insure that result by placing nothing but white balls in the urn." (p. 292) He points out in essence that Marx has presented a forced card in limiting his discussion to commodities in the first place. He catches Marx equivocating on the term "commodities"--at one time using it to imply anything which is the subject of an economic transaction, and at another time limiting it to a much narrower reference. Marx excludes from consideration all natural resources, including land, in his search for the nature of value. But when he finds his principle, he immediately assumes that it applies to everything which is traded or tradeable, including those same natural resources.

Not only does Marx thus unfairly limit his consideration to commodities; he eliminates use value from his equation by confusing use-value-in-general with specific uses to which commodities are put; he assumes erroneously that, having done this, he has eliminated all possible determinants of value except labor (ignoring such factors as scarcity, being objects of supply and demand, and being made of natural materials); and immediately after he has implied that the abstract concept of use value could have no place in his search for value, he arrives at the abstract concept of labor time--so that, as Böhm-Bawerk puts it, "If Marx had happened to reverse the order of his inquiry, he could have eliminated labor by the very same logical succession which led him to the elimination of use value." (p. 297)

Böhm-Bawerk states that the structural weakness of this presentation makes it impossible that it represents the way Marx himself arrived at the conclusion that labor is the source of all value. He therefore concludes that Marx constructed the theory to prove a preconceived notion: ". . .he tinkered and puttered around, manipulating the compliant concepts and premises of his thesis, until at long last the predetermined and premeditated result was finally produced in a form that was to all outward appearances reputable and conclusive." (p. 298)

As a final nail in the coffin of this theory, Böhm-Bawerk lists the categories of goods whose market value is not in proportion to the quantity of labor necessary for their production. These include (1) rare goods, a class of goods which Böhm-Bawerk points out is not limited to statues, paintings, rare books and vintage wines, but "this class of goods also includes all real estate, plus the myriad goods involving patents, copyrights and trade secrets." (p. 298) (2) all goods produced by skilled rather than unskilled labor. "Almost every commodity will require, somewhere in the course of its production, specialized labor of some kind--that of an inventor, a manager, a foreman and the like. And that--in terms of the labor theory of value--raises the value of that commodity somewhat above the level that it would have attained on the basis of the quantity of labor alone." (3) "handwork done by women," which sold at the turn of the century for less than the market price of labor. (4) fluctuations in exchange value which

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reflect fluctuations in supply and demand. "To my way of thinking the socialist adherents of the labor principle are far too ready to shrug off this exception nonchalantly. . . . It cannot be denied that all these irregularities constitute just that many examples of exchange values which are the result of factors other than the quantity of labor costs. At the least, this should have started an investigation into the question as to whether there might not be some other principle of exchange value." (p. 300) (5) goods which require "the greater advance outlay of 'preliminary' labor," e.g., a 100-year-old oak tree "has a higher price than can correspond to the half minute it takes to plant the acorn."

Böhm-Bawerk summarizes in the following way: "The alleged 'law' provides that the exchange value of goods is determined by the quantity of labor embodied in them. It is a law which a considerable proportion of goods does not obey at all, and the rest not always, and never exactly. Such is the empirical material with which he must deal who would formulate a theory of value. What conclusions can the impartial theorist draw from such material? Surely not that the origin and determinant of all value is to be found solely in labor." (p. 301, Italics his)

Böhm-Bawerk thought, as he worked on the third edition of his text shortly before his death in 1914, that the influence of the exploitation theory was on the wane, but that he should take it seriously enough to answer it in detail in case there should be, some time in the future, "renewed controversy." The rest of this century has been the history of that renewed controversy. Why should this be? Why is Böhm-Bawerk reprinted as recently as 1960 and recirculated as a new idea?

The complete answer would be a complicated socio-political-philosophical one, involving factors of history as well as ideas. But even in these few pages in which Professor Böhm-Bawerk so brilliantly demolishes the most fundamental Marxist economic doctrine, he indicates an alternative conclusion with which it is impossible for any consistent defender of capitalism to agree. In speaking of the fact that he had not specifically discussed the role of "the rest of the participants in production," Böhm-Bawerk says, "The correctness or incorrectness of the exploitation theory does not depend on whether or not those parts of the national product which are not expended as wages are dispensed on an accurately graded scale which is in accordance with the true deserts of the participating parties. It depends solely and only on whether it can be proved that what the workers have earned constitutes an unqualified claim to an artificially premature payment to them of the total product. If that cannot be proved, then the exploitation theory is wrong. Then part of the product remains, and other claimants may then urge their legal or just pretensions to it. In the absence of such claims let an enlightened system of law dispose of it in accordance with such considerations of expediency as give due regard to the permanent advancement of the common good. Such might be quite possible, and indeed there seems to be a strong tendency in that direction in the development of our system

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of jurisprudence as evidenced by modern social security, graduated income taxes, increasing government ownership and controls and so on. Yes, it is quite possible, I say, that the share of the workers, based on naturally justified claims, will be increased temporarily by our laws through artificial measures based on considerations of expediency in the best sense of the word. And the increase would come out of that part of the national product still available after wages. And so, directly or indirectly, there would be a limitation of the income that is derived solely by virtue of possession." (p. 319)

And so the same man who was so rigourously just when it came to examining the claims of the workers to the total product, who in his discussion of Rodbertus stated unequivocally that if the labor theory of value were correct, then the claim of the worker to the entire value of the product must follow ("there can be no question of its correctness and its fairness")--this same man, now that he has shown unequivocally that the interest which the capitalist gains is not exploited from the worker, asks for additional "legal or just pretensions" to show that the capitalist is entitled to it.

If anyone still wonders why we consider that capitalism must not be defended on any grounds other than the rights of individuals, let him analyze the statement cited above, carefully, and notice the failure of political philosophy inherent in it. Why does the worker have a "naturally justified claim" to an increased share of the income which, "solely by virtue of possession" remains in the hands of the capitalist? In what way do "increasing government ownership and controls" give "due regard to the permanent advancement of the common good"? What happened to private property?

In spite of the fact that Böhm-Bawerk has brilliantly and detailedly shown that, in fact, the interest which the capitalist obtains is the result of his control of capital and not of the exploitation of anybody, he still does not consider that property is a right. The exploitation theory turned utilitarian defenders of laissez-faire, who considered rights a fiction and sought "the greatest good for the greatest number," into utilitarian defenders of socialism. In reading Böhm-Bawerk we see that even an intellectual opponent of the exploitation theory could find no just basis for private property if it was a large amount of private property, that is, if it was "that part of the national product still available after wages."

It is not really so surprising that the controversy between individual rights and "the common good" continues today.

--Joan Kennedy Taylor

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